

to: **Jim Odiorne** from: **March 21, 2003**
from: **Sandi Hunt** subject: **Outstanding items**

Per your request, the accompanying tables describe the items that have been requested of Premera that remain outstanding and the effect of the missing items on our ability to complete our analysis. Several of the remaining items are sufficiently critical that we cannot complete our report in their absence.

There are several categories of missing items, subset by major analytic area. A brief description of the impact of the missing materials is provided here, with additional detail provided in the accompanying spreadsheet. It is important to note that many of the outstanding items have impact on multiple areas of the analysis, including those for which we are responsible as well as other consultants.

Some of the specific outstanding items relate to the following areas:

Executive Compensation

- We are attempting to assess Premera's executive compensation levels. The level of compensation, as well as recent and projected changes in compensation are fundamental to assessing several components of the proposed transaction, including whether the executives will experience undue increases in pay, and whether the financial markets will consider the compensation levels and mix of cash and incentive pay to be appropriate for a for-profit entity. Premera has indicated they do not intend to describe the stock incentive plans for executives until their conversion to a for-profit entity has been approved. By definition, we will not be able to comment on the perceived appropriateness of the plan until the proposal has been disclosed. We also require five-year historical information on compensation for key executives to provide a point of comparison.

Actuarial and Financial Projection Data and Models

- Several outstanding documents relate to the actuarial valuation and financial projections, including WA 20, WA 60, and WA 74. These documents are fundamental to several components of the analysis. Specifically, they address:
 - the split of value between Alaska, Washington, and potentially other constituents and consequently the value of the foundations; and

- the potential value of the company and the foundations at the time the company would become a publicly traded firm.
- These items are also critical to the economic impact analysis to allow us to assess the likely changes that will occur as a consequence of the conversion.

Tax Issues

- There are a number of important tax issues that remain outstanding, comprised of multiple outstanding document requests. These documents pertain to both the final sign-off on the tax documents that have been presented as well as the potential tax status of the proposed foundations and the ability of Premera to retain certain tax advantages. These issues affect the actuarial and financial projection valuations as well as the economic impact analysis.

Many of the items that remain outstanding are currently considered privileged, and we are working with the OIC and other consultants to address the privilege log. Others require additional analysis or document production.

Please call me at 415/498-5365 if you have any questions regarding these tables.

Summary of Outstanding Data Requests and Project Updates: PwC

OUTSTANDING DATA REQUESTS AND IMPLICATIONS: COMPENSATION

Description of Outstanding Items	Consequences of Not Receiving Material		Cross Reference
	Impact on Analysis	Comments	
<p>⊕ Additional turnover statistics - Although we did receive turnover statistics by functional area, conclusions will be more meaningful if we can benchmark turnover by position level (i.e., EVP, SVP, VPs, managers, professional, etc.). From a practical standpoint, survey providers generally report by position vs. function.</p>	Moderate to High	<p>⊕ Premera asserts that the conversion will enhance turnover, which the OIC wishes to test</p> <p>⊕ To determine the validity of this statement, we need to evaluate Premera's historical and post-IPO attrition rates as compared to competitive practice</p>	<p>Requested as WA 113</p> <p>According to Premera, we will not receive this information.</p> <p>Premera cannot provide turnover by level. Systems limitations prevent such a query.</p>
<p>⊕ 5-year compensation history (1998 – 2002) including salary, bonus (amounts deferred and paid) and long-term incentives for CEO, EVPs, SVPs and other selected benchmark jobs (i.e., director, manager, VP level jobs).</p> <p>▲ 1998, 1999, and 2000 base salaries</p> <p>▲ 1998, 1999, and 2000 annual bonuses earned (before any deferrals)</p> <p>▲ 1998, 1999, and 2000 long-term incentives earned (before any deferrals)</p> <p>▲ 2002 long-term incentive earned (during the 3-year performance period 2000-2002) by the CEO and all EVPs and all SVPs</p> <p>▲ Current executive deferred compensation account balances (cumulative) for the CEO,</p>	High	<p>⊕ Compensation history is needed to determine whether increases in executive pay are consistent with competitive practice and reasonable in comparison to amounts provided to department heads and managers.</p>	<p>E 445 (salary & bonus history for benchmark jobs); Assumes that this will be sufficient detail to fulfill earlier request in WA21a</p> <p>Incomplete</p>

Summary of Outstanding Data Requests and Project Updates: PwC

Description of Outstanding Items	Consequences of Not Receiving Material		Cross Reference
	Impact on Analysis	Comments	
all EVPs and all SVPs.			

OUTSTANDING DATA REQUESTS AND IMPLICATIONS: COMPENSATION

Description of Outstanding Items	Consequences of Not Receiving Material		Cross Reference
	Impact on Analysis	Comments	
<ul style="list-style-type: none"> ⊕ In addition, we need the following key dates for each executive: <ul style="list-style-type: none"> ▲ Date of Birth ▲ Date of Hire ▲ Date of Promotion to SVP ⊕ Proposed stock option plan <ul style="list-style-type: none"> ▲ Authorization ▲ Allocation ▲ Initial grants ⊕ Proposed incentive plans ⊕ Proposed salary changes 	Very High	<ul style="list-style-type: none"> ⊕ Information is needed to determine reasonableness of compensation programs post-IPO. ⊕ Reasonableness assessment to be completed to the extent possible with information as provided in the exhibits to Form A as filed. ⊕ Conclusions concerning reasonableness are to be considered tentative and subject to review of final plan terms and provisions. 	<p>Requested as WA105 **</p> <p>** Removed from list because Premera indicates that it is unlikely to be developed until IPO filing.</p> <p>PwC believes lack of such info seriously compromises compensation and fairness analysis.</p>

Summary of Outstanding Data Requests and Project Updates: PwC

OUTSTANDING DATA REQUESTS AND IMPLICATIONS: ACTUARIAL ANALYSIS

Description of Outstanding Items	Consequences of Not Receiving Material		Cross Reference
	Impact on Analysis	Comments	
⊕ Complete Statutory Annual Statements for all years of operation of Premera Blue Cross and its predecessor companies	High	⊕ Ability to accurately analyze historical underwriting results of WA and AK sub-components of Premera results is compromised by gaps in data, specifically 1957 to 1960. Require confirmation from Premera that data compiled from OIC records is correct.	WA 20
⊕ Internal Financial Statements that show detailed gain/loss by product line (LOB reports).	High	⊕ Require confirmation from Premera that data compiled from OIC records is correct.	WA 60
⊕ Financial Projections with impact on Form A filing	Critical	⊕ Many issues are currently unresolved related to financial projections ⊕ The comparison of historical financials on WA 26 versus WA 74 (Projections) needs to be discussed and resolved (also E 470) ⊕ S G & A expense allocation does not appear to match pricing expectations nor meet a general reasonableness check. Expenses will need to be analysed and reallocated (also E 482) ⊕ A reconciliation of WA 26/74 to the Form A filing will need to be finalized.	WA 74 E 470 E 482

Summary of Outstanding Data Requests and Project Updates: PwC

OUTSTANDING DATA REQUESTS AND IMPLICATIONS: ACTUARIAL ANALYSIS

Description of Outstanding Items	Consequences of Not Receiving Material		Cross Reference
	Impact on Analysis	Comments	
⊕ Request for e-mail of rate development methodology	High	⊕ Require most recent rate development models & meeting to discuss current underwriting guidelines.	WA 82 & Meeting requests M10, M12, M13

Summary of Outstanding Data Requests and Project Updates: PwC

OUTSTANDING DATA REQUESTS AND IMPLICATIONS: TAX

Description of Outstanding Items	Consequences of Not Receiving Material		Cross Reference
	Impact on Analysis	Comments	
⊕ Any internal memoranda whether in draft or final form related to the conversion and its impact on the Company, the policyholders, or the Foundation.	Critical	⊕ Privilege Asserted.	WA 49
⊕ Any tax opinions, or memoranda (both internal or external) whether in draft or final form relating to whether Premera has previously undergone a material change in operations or structure pursuant to IRC section 833.	Critical	⊕ Privilege Asserted.	WA 50
⊕ Written representations made by Premera management to Ernst & Young LLP in connection with E&Y's issuance of tax opinions related to the tax-free treatment of the conversion transaction, the application of IRC Sec. 382 to the transaction, and the impact of the transaction on whether the conversion will result in a "material change in structure or operations".	Critical	⊕ Received long-form legal opinion including representations. However, opinion indicates that Premera and its affiliates have not agreed to the representations set forth in the opinion. Will want to review the representations once they have been agreed to by Premera. Premera will not provide reps until the day of approval. PwC will need to review those reps prior to close of the deal. (3/11/03). Richard Ashley to discuss with Jim Odiorne (3/14/03)	E 438
⊕ Detailed and well-reasoned written analysis of the legal basis and risks supporting the tax opinions issued by E&Y.	Critical	⊕ Privilege Asserted. Received long-form tax opinion addressing the tax-free reorganization and 382 limitations (Feb. 14th). Have not received any analysis in connection with the material change	E 439

Summary of Outstanding Data Requests and Project Updates: PwC

opinion.

Summary of Outstanding Data Requests and Project Updates: PwC

OUTSTANDING DATA REQUESTS AND IMPLICATIONS: TAX

Description of Outstanding Items	Consequences of Not Receiving Material		Cross Reference
	Impact on Analysis	Comments	
⊕ Assumptions and detailed analysis supporting the additional federal income tax that would result if the Sec. 833(b) deduction is lost as a result of the conversion transaction as presented to the Board of Directors on January 24, 2002 (bates #0016785). Please provide this analysis for the taxable year which includes the conversion transaction as well as all subsequent years through 2014 consistent with the Board presentation	Critical	⊕ Privilege Asserted.	E 452

Summary of Outstanding Data Requests and Project Updates: PwC

OUTSTANDING DATA REQUESTS AND IMPLICATIONS: TAX

Description of Outstanding Items	Consequences of Not Receiving Material		Cross Reference
	Impact on Analysis	Comments	
⊕ Follow up tax requests by PWC submitted to Premera. Written and numerical analysis explaining assumptions and methodologies.	Critical	⊕ Incomplete Response	874-883
⊕ PWC concerns regarding the adequacy of the opinions issued by Ernst & Young in regard to Section 368/382 and Section 833(b) opinions, ability of states to rely on such opinions and other issues	Critical	⊕ Incomplete Response	884-894
⊕ Questions and issues in regard to States West Life	High	⊕ Incomplete Response	895-897
⊕ Other tax issues and questions	Critical	⊕ Incomplete Response	898-910

Summary of Outstanding Data Requests and Project Updates: PwC

OUTSTANDING DATA REQUESTS AND IMPLICATIONS: AUDIT

Description of Outstanding Items	Consequences of Not Receiving Material		
	Impact on Analysis	Comments	Cross Reference
⊕ Phone call and/or meeting with the manager or director of billing and other appropriate personnel to discuss various accounts receivable balances	High	⊕ This is to understand the composition, fluctuation, significant customers, and trends in the balance ⊕ Open – Request has been submitted to have this meeting during the week ending March 30, 2003.	Follow-up to E498
⊕ Phone call and/or meeting with Finance Department with potential follow-up with Kent Marquadt. The purpose is to follow-up up on responses, discuss fluctuations, and answer various questions derived from our analysis.	High	⊕ Necessary to close a number of open items and tie together our analysis ⊕ Open – Request has been submitted to have this meeting during the week ending March 30, 2003.	Follow-up to WA 28, E457, E483, E498 & E469
⊕ Discussion with finance department personnel to understand how expenses are coded to the appropriate cost center	High	⊕ Necessary to better understand the allocation of G&A expenses to each state ⊕ Open – Can be incorporated into the call / meeting with the Finance Department requested to occur during the week ending March 30, 2003.	Included in January 6, 2003 memo

Summary of Outstanding Data Requests and Project Updates: PwC

OUTSTANDING DATA REQUESTS AND IMPLICATIONS: AUDIT

Description of Outstanding Items	Consequences of Not Receiving Material		Cross Reference
	Impact on Analysis	Comments	
⊕ Understanding of the administrator and the insurance company behind physician's pension plan.	Medium	<p>⊕ Necessary to determine if there are valuation issues associated with the assets. We understand the original holder of the policy has gone out of business.</p> <p>⊕ Open - Can be incorporated into the call / meeting with the Finance Department requested to occur during the week ending March 30, 2003.</p>	

Summary of Outstanding Data Requests and Project Updates: PwC

OUTSTANDING DATA REQUESTS AND IMPLICATIONS: ECONOMIC IMPACT ANALYSIS

Description of Outstanding Items	Consequences of Not Receiving Material		Cross Reference
	Impact on Analysis	Comments	
⊕ Actuarial items described above	Critical	⊕ Many of the items described in the actuarial section are also required for the economic impact analysis. In particular, it is critical that we have a good understanding of the financial forecast for the future, as well as the allocation of expenses in the past and future. Underwriting and rate setting methodology are also critical.	